

STATEMENT OF
HONORABLE DONALD J. DEVINE
DIRECTOR OFFICE OF PERSONNEL MANAGEMENT

before the

SUBCOMMITTEE ON COMPENSATION
AND EMPLOYEE BENEFITS
COMMITTEE ON POST OFFICE AND CIVIL SERVICE
U.S. HOUSE OF REPRESENTATIVES

On

FISCAL YEAR 1986 BUDGET PROPOSALS
CONCERNING CIVIL SERVICE RETIREMENT,
FEDERAL EMPLOYEES HEALTH BENEFITS,
AND FEDERAL PAY

FEBRUARY 26, 1985

MADAM CHAIR AND MEMBERS OF THE SUBCOMMITTEE:

THANK YOU FOR INVITING ME TO APPEAR THIS AFTERNOON TO DISCUSS THE ADMINIS-
TRATION'S FISCAL YEAR 1986 BUDGET PROPOSALS ON CIVIL SERVICE RETIREMENT,
FEDERAL EMPLOYEES HEALTH BENEFITS, AND FEDERAL PAY.

CIVIL SERVICE RETIREMENT

A RECENT INDEPENDENT STUDY BY THE CONSULTING FIRM OF TOWERS, PERRIN, FORSTER,
AND CROSBY FOUND THAT THE AVERAGE EMPLOYER COSTS OF PENSIONS IN THE PRIVATE
SECTOR--FOR THE HALF OF THE POPULATION WHICH HAS PENSIONS--WAS 18 PERCENT
OF PAYROLL, COMPARED TO THE GOVERNMENT'S 28 PERCENT OF PAYROLL. EVEN MORE
IMPORTANT, THE STUDY FOUND THAT THE PROVISION OF BENEFITS WAS VERY UNEVEN
BETWEEN DIFFERENT SEGMENTS OF THE WORKFORCE. DATA SHOW THAT 45 PERCENT OF
A COHORT OF NEW EMPLOYEES WILL ACTUALLY SUBSIDIZE THE RETIREMENT SYSTEM, AND
ANOTHER 15 PERCENT WILL RECEIVE NO REAL BENEFITS. ALMOST 60 PERCENT WILL DO
VERY POORLY, WHILE A RELATIVELY SMALL GROUP DOES EXTREMELY WELL. THE CIVIL

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SERVICE RETIREMENT SYSTEM IS THE GOVERNMENT'S THIRD LARGEST ENTITLEMENT PROGRAM WITH AN OUTLAY OF APPROXIMATELY \$23 BILLION IN 1985. IT HAS A DYNAMIC UNFUNDED LIABILITY OF OVER A HALF A TRILLION DOLLARS. IT IS A SYSTEM BADLY IN NEED OF REFORM.

THIS ADMINISTRATION IS COMMITTED TO MAKING THAT REFORM FOR THE SAKE OF BOTH GOOD PERSONNEL MANAGEMENT AND SOUND FINANCIAL ADMINISTRATION. IN 1986, OUR PROPOSED RETIREMENT REFORMS WOULD REDUCE OUTLAYS BY \$731 MILLION AND INCREASE RECEIPTS BY \$269 MILLION. I WOULD LIKE TO DISCUSS EACH OF THESE REFORMS IN TURN.

FIRST, WE PROPOSE TO REVISE THE WAY CIVIL SERVICE ANNUITIES ARE ADJUSTED TO REFLECT CHANGES IN THE COST OF LIVING. CURRENT LAW ENSURES THAT FEDERAL ANNUITANTS, UNLIKE MOST OTHER RETIREES OUTSIDE GOVERNMENT OR EVEN ACTIVE FEDERAL WORKERS, WILL BE COMPLETELY ISOLATED FROM ANY EFFECTS OF INFLATION, SINCE THEIR ANNUITIES ARE REQUIRED TO BE ADJUSTED EACH YEAR TO REFLECT FULL INCREASES IN THE COST OF LIVING AS MEASURED BY THE CONSUMER PRICE INDEX (CPI). CONSEQUENTLY, AS FEDERAL RETIREMENT BENEFITS HAVE RISEN AT A FASTER RATE THAN PAY, MANY RETIREMENT-ELIGIBLE INDIVIDUALS HAVE FOUND IT FINANCIALLY ADVANTAGEOUS TO LEAVE FEDERAL SERVICE. THIS DISINCENTIVE TO WORK HAS TAKEN A PARTICULAR TOLL ON EXPERIENCED AND VALUABLE SENIOR PERSONNEL. REMOVING THIS DISINCENTIVE CONTINUES TO BE A PARAMOUNT PERSONNEL MANAGEMENT CONCERN.

OUR APPROACH TO THE PROBLEM INVOLVES SEVERAL STEPS, STARTING WITH THE ELIMINATION OF THE COST-OF-LIVING ADJUSTMENT (COLA) NOW SCHEDULED FOR THIS DECEMBER. THIS COLA FREEZE WOULD BE CONSISTENT WITH COLA FREEZES BEING PROPOSED FOR A NUMBER OF OTHER INDEXED PROGRAMS, INCLUDING MILITARY RETIRED PAY. THEN, BEGINNING WITH THE DECEMBER 1986 COLA, OUR

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COLA AMOUNT WOULD BE THE LESSER OF THE INCREASE IN GENERAL SCHEDULE PAY OR THE CPI CHANGE TO GIVE RETIREES AND EMPLOYEES EQUAL TREATMENT. THAT COLA WOULD BE PAYABLE ON THE FIRST \$10,000 OF ANNUITY. PENSIONS OVER \$10,000 WOULD BE INCREASED BY 55 PERCENT OF THE COLA. IN SUBSEQUENT YEARS, THE \$10,000 BASE AMOUNT TO WHICH THE FULL INCREASE APPLIES WOULD BE ADJUSTED BY THE PERCENTAGE OF THE PREVIOUS YEAR'S COLA. THIS CHANGE WOULD BRING FEDERAL RETIREES INTO CLOSER ALIGNMENT WITH OTHER RETIRED PEOPLE, WHO TYPICALLY RECEIVE FULL COLA'S ONLY ON THEIR SOCIAL SECURITY BENEFITS, AND ONLY ABOUT ONE-THIRD OF THE COLA ON ANY PRIVATE PENSION PAYMENTS THEY RECEIVE.

SECOND, THE BUDGET PROPOSES TO ELIMINATE A PRACTICE UNDER OUR RETIREMENT SYSTEM VIRTUALLY UNKNOWN IN THE PRIVATE SECTOR--UNREDUCED RETIREMENT BENEFITS AS EARLY AS AT AGE 55. WE PROPOSE THAT CURRENT FEDERAL EMPLOYEES WITH SUFFICIENT SERVICE CONTINUE TO BE ABLE TO RETIRE AS EARLY AS AGE 55, BUT BENEFITS WOULD BE REDUCED TO REFLECT THE COST TO THE RETIREMENT SYSTEM OF THIS EARLY RETIREMENT. FOR EACH YEAR THE EMPLOYEE IS UNDER AGE 65 AT THE TIME OF RETIREMENT, THE ANNUITY WOULD BE REDUCED BY 5 PERCENT. THIS REDUCTION WOULD NOT APPLY TO ANYONE WHO IS ALREADY 55, AND IN ORDER TO EASE ITS IMPACT ON THOSE NEAR RETIREMENT, THE REDUCTION WOULD BE PHASED IN OVER 10 YEARS. FOR INSTANCE, AN EMPLOYEE WHO IS NOW 54 COULD RETIRE AT 55 WITH AN ANNUITY REDUCTION OF ONLY 5 PERCENT. ONLY THOSE NOW 45 AND UNDER WOULD BE SUBJECT TO THE FULL REDUCTION. LIKE THE COLA CHANGE, THIS PROPOSAL WOULD BRING FEDERAL RETIREES INTO CLOSER ALIGNMENT WITH RETIREES IN OTHER SECTORS OF THE ECONOMY, WHERE RETIREMENT AT AGE 55 WITH UNREDUCED BENEFITS IS RARELY PERMITTED.

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THIRD, AGAIN FOLLOWING THE NORMAL PATTERN FOLLOWED IN THE PRIVATE SECTOR, WE PROPOSE TO BASE ANNUITY COMPUTATIONS ON THE RETIREE'S HIGHEST FIVE YEARS OF EARNINGS, RATHER THAN THE HIGHEST THREE. PRIOR TO 1969, A PERIOD OF LOW INFLATION, THE HIGH-FIVE YEARS' SALARY WAS USED. SINCE THEN, COMPUTATIONS HAVE BEEN BASED ON THE HIGH-THREE. EMPLOYEES WHO ARE WITHIN THREE YEARS OF ELIGIBILITY FOR RETIREMENT WOULD NOT BE AFFECTED.

FOURTH, WE WOULD PHASE OUT OVER A FOUR-YEAR PERIOD THE RETIREMENT CREDIT CURRENTLY GIVEN FOR UNUSED SICK LEAVE. THIS TYPE OF BENEFIT IS NOT ONLY VERY EXPENSIVE BUT ALSO IS NOT TYPICALLY AVAILABLE TO NON-FEDERAL WORKERS.

FIFTH, WE PROPOSE CHANGES THAT ARE CONSISTENT WITH ENACTED REFORMS AND OTHER EXISTING PROVISIONS IN SOCIAL SECURITY. THESE INCLUDE DELETING THE GUARANTEED MINIMUM BENEFIT FOR FUTURE ANNUITANTS, PHASING OUT SPECIAL BENEFITS FOR ADULT STUDENTS, AND CHANGING ELIGIBILITY RULES FOR SURVIVING SPOUSES, FORMER SPOUSES, AND INSURABLE INTEREST BENEFICIARIES TO PARALLEL MORE CLOSELY THE TREATMENT OF SIMILARLY SITUATED INDIVIDUALS COVERED BY SOCIAL SECURITY.

SIXTH, WE WOULD REQUIRE THE POSTAL SERVICE AND THE D.C. GOVERNMENT TO CONTRIBUTE TO THE RETIREMENT FUND AN ADDITIONAL 2 PERCENT OF BASIC PAY EACH YEAR UNTIL THEIR PAYMENTS, PLUS EMPLOYEE DEDUCTIONS, ARE SUFFICIENT TO COVER THE DYNAMIC NORMAL COST OF THE RETIREMENT SYSTEM. THE D.C. GOVERNMENT AND THE POSTAL SERVICE ARE SUPPOSEDLY NOW SELF-SUPPORTING, WITH ANY FEDERAL SUBSIDIES CLEARLY IDENTIFIED AS SUCH. YET THESE TWO ENTITIES ARE CONTINUING TO RECEIVE MASSIVE HIDDEN SUBSIDIES THROUGH THEIR PARTICIPATION IN THE CIVIL SERVICE RETIREMENT SYSTEM.

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FINALLY, AS A PART OF THE ONGOING EFFORT TO DISENTANGLE FEDERAL AND DISTRICT OF COLUMBIA AFFAIRS, WE PROPOSE TO EXCLUDE EMPLOYEES HIRED BY THE GOVERNMENT OF THE DISTRICT OF COLUMBIA AFTER SEPTEMBER 30, 1985, FROM THE FEDERAL RETIREMENT, LIFE INSURANCE, AND HEALTH BENEFITS PROGRAMS.

FEDERAL EMPLOYEES HEALTH BENEFITS

NOW I WOULD LIKE TO TURN TO THE FEDERAL EMPLOYEES HEALTH BENEFITS (FEHB) PROGRAM, WHERE WE ARE AGAIN PROPOSING A MAJOR LEGISLATIVE REFORM. THE PRESENT FEHB PROGRAM HAS MANY VERY GOOD FEATURES, ESPECIALLY ITS WIDE CHOICE OF PLANS AVAILABLE. TO ENHANCE THIS MOST ATTRACTIVE FEATURE, WE HAVE PROPOSED A SYSTEM THAT IS POPULARLY KNOWN AS A "VOUCHER" SYSTEM. WE BELIEVE THIS APPROACH CAN MAKE A VALUABLE CONTRIBUTION TO THE FEHB PROGRAM.

UNDER THIS SYSTEM, OPM WOULD NO LONGER NEGOTIATE DETAILED CONTRACTS WITH CARRIERS. INSTEAD, ANY CARRIER THAT IS PREPARED TO MEET CERTAIN MINIMAL REQUIREMENTS WOULD BE ADMITTED TO THE PROGRAM, AND WOULD BE FREE TO OFFER ANY NUMBER OF PLANS IT WISHED. ALL PLANS WOULD BE REQUIRED TO INCLUDE CATASTROPHIC COVERAGE, BUT CARRIERS WOULD OTHERWISE BE FREE TO DESIGN THEIR BENEFIT PACKAGES IN WHATEVER WAY THEY THINK WOULD ATTRACT THE MOST ENROLLEES. ENROLLEES WOULD RECEIVE INFORMATION TO HELP THEM IN SELECTING THE PLAN BEST SUITED TO THEIR NEEDS. PARTICIPATION BY A WIDER RANGE OF PLANS WOULD INCREASE THE NUMBER OF CHOICES AVAILABLE TO ENROLLEES, FURTHER SHARPENING THE COMPETITIVE FORCES THAT HAVE MADE THE CURRENT PROGRAM SUCCESSFUL.

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THE GOVERNMENT CONTRIBUTION WOULD NO LONGER BE CAPPED AT THE CURRENT 75 PERCENT OF A PLAN'S PREMIUMS SO ENROLLEES WOULD NO LONGER BE PENALIZED FOR ENROLLING IN A LOW-COST PLAN. ENROLLEES WOULD EVEN BE ABLE TO RECEIVE A REBATE IF THE PREMIUM FOR THE PLAN THEY CHOOSE IS LESS THAN THE GOVERNMENT CONTRIBUTION. THE GOVERNMENT CONTRIBUTION WOULD NO LONGER BE DETERMINED BY THE PREMIUM COSTS OF PARTICULAR PLANS, BUT WOULD INSTEAD BE BASED ON THE DOLLAR AMOUNTS OF THE AVERAGE GOVERNMENT CONTRIBUTIONS FOR SELF-ONLY AND SELF-AND-FAMILY COVERAGES IN THE YEAR PRIOR TO INAUGURATION OF THE VOUCHER, ADJUSTED IN FUTURE YEARS BY PERCENTAGE CHANGES IN A GENERAL PRICE INDEX.

FEDERAL PAY

THE BUDGET PROPOSES A ONE-TIME REDUCTION IN PAY OF 5 PERCENT, EFFECTIVE IN JANUARY OF 1986, FOR FEDERAL CIVILIAN EMPLOYEES. AS YOU RECALL, DURING THE RECESSION, LABOR UNIONS IN THE PRIVATE SECTOR RENEGOTIATED THEIR CONTACTS AND TOOK CUTS TO HELP THEIR INDUSTRIES GET BACK ON THEIR FEET AGAIN. IT SEEMS ONLY APPROPRIATE THAT GOVERNMENT EMPLOYEES, TOO, SHOULD CONTRIBUTE IN A SIMILAR WAY TO HELP THEIR EMPLOYER AND TO SHARE IN CUTTING THE COST OF GOVERNMENT. A CORPORATION WITH A \$200 BILLION RED INK BALANCE AND A \$500 BILLION UNFUNDED PENSION LIABILITY SURELY IS A BUSINESS IN TROUBLE. WE MUST ALL SHARE IN PUTTING OUR HOUSE BACK IN ORDER.

THANK YOU. I WOULD BE HAPPY TO ANSWER ANY QUESTIONS THE SUBCOMMITTEE MAY HAVE.